

October 24, 2003

MEMORANDUM FOR LMSB INDUSTRY DIRECTORS  
DIRECTORS, FIELD OPERATIONS, COMMUNICATIONS,  
TECHNOLOGY & MEDIA  
DIRECTOR, FIELD SPECIALISTS  
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE

FROM: Thomas W. Wilson, Jr.  
Industry Director, Communications, Technology & Media

SUBJECT: Examination of Sports Franchise Acquisitions.

In an effort to effectively utilize resources, Communication, Technology and Media (CTM) announces a directive that provides examining agents with a tool to be used in the classification and examination of taxpayers who acquired sports franchises. This directive reflects a management decision to balance resources and workload priorities. This directive is not an official pronouncement of law or Service position and cannot be used, cited or relied upon as such.

Background

Generally, approximately 90 percent of the assets of a sports franchise consist of intangibles. These intangible assets include, for example, the franchise itself, player contracts, media rights, and various preferred seating rights such as luxury suite and club seating agreements as well as playing facility naming rights agreements. When a sports franchise is acquired, the acquisition of these intangibles presents significant questions of valuation and eligibility for amortization.<sup>1</sup>

I.R.C. § 1060 generally requires the purchaser of a sports franchise to allocate the purchase price among the acquired assets, except for goodwill and going concern value, in proportion to the fair market value of each acquired asset. In the purchase price allocation, significant tension exists in the allocation between amortizable and non-amortizable assets such as franchise or league membership rights value. For example, the allocation between amortizable player contracts and non-amortizable franchise or league membership rights value is a highly disputed matter in virtually every examination.

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<sup>1</sup> Under I.R.C. § 197, a taxpayer is allowed a 15-year ratable amortization deduction of the basis of any section 197 intangible asset. Section 197 intangible assets include a broad range of intangible assets including goodwill and going concern value. Section 197 was enacted to minimize disputes concerning the valuation of intangibles and their eligibility for amortization. Section 197 assets, however, do not include a franchise to engage in professional sports, and any item acquired in connection with such a franchise.

Similarly, disagreement exists concerning an appropriate methodology for the valuation of player contracts as well as the application of the player contract basis limitation rules of I.R.C. § 1056, including the rebuttable presumption that no more than 50 percent of the gross purchase price of a sports team may be allocated to such contracts. Consequently, the valuation and amortization of player contracts represents another contentious area between taxpayers and the Service.

The valuation and amortization of media rights represent yet another highly contentious area between the Service and sports franchise taxpayers. Currently, a particular dispute exists between taxpayers and the Service concerning whether a sports franchise's rights to media revenues as evidenced by media contracts in place at the time of acquisition are amortizable.

In the past decade, the sports industry has been marked by a jump in the sales of existing and expansion teams. In these situations, taxpayers and the Examination function are often engaged in substantial disputes concerning the allocation to amortizable assets and whether certain intangible assets are amortizable. Thus, in securing compliance in the sports industry, considerable resources (including the engagement of outside industry and valuation experts) are expended in the examination of franchise acquisition issues. In order to more effectively utilize examination resources, agents will resolve acquisition issues in cases in the examination process in a more focused and expedited manner by applying a compliance measure as more fully described below.

### Compliance Measure

Subject to certain limitations, in the case of the acquisition of a sports franchise, agents will consider the taxpayer's allocation to, and amortization of, intangible assets acquired in such acquisition to be acceptable compliance if:

The sum of the present values of amortization deductions (claimed and to be claimed) for acquired amortizable intangible assets (not taking into account any amortization claims for media rights) yields an amount that does not exceed 60% of the purchase price allocable to all acquired intangibles.

The 60% mark represents the upper end of a compliance measure. A taxpayer is not automatically entitled to amortization deductions that in present value terms would equal the 60% mark. A taxpayer must in fact acquire amortizable assets that would satisfy the 60% maximum compliance measure mark.

## Application of the Compliance Measure

1. *Availability of Compliance Measure.* Subject to the limitations described below, examiners will offer the use of the compliance measure in any examination which, on or after the date of this directive, is open and in which the acquisition issues remain unresolved (i.e., Examination and the taxpayer have not reached an agreement resolving the acquisition issues). A taxpayer who accepts Examination's use of the compliance measure will be required to enter into a closing agreement in Examination resolving the acquisition issues under the measure.

2. *Media Rights.* The Service's position is that media rights are non-amortizable. Therefore, no amortization deductions for any media rights will be allowed in determining whether a taxpayer satisfies the compliance measure. Taxpayers will be free to pursue any denied deduction for amortization of media rights in Appeals or in the courts. We encourage the use of Fast Track procedures to resolve the issue in the field.

3. *Compliance Measure Adjustments.* Agents will make no adjustment to a taxpayer's claimed (or to be claimed) amortization deductions in cases in which the sum of the present values of a taxpayer's claimed (and to be claimed) amortization deductions from those assets (not taking into account any media rights) is equal to or below the 60% compliance measure mark. If the sum of the present values of the claimed (and to be claimed) amortization deductions exceeds the 60% compliance measure mark, agents will make an adjustment to claimed (and to be claimed) amortization deductions so as to achieve a present value percentage that does not exceed the 60% compliance measure mark. Agents should refer to the Industry Director's Directive, being issued simultaneously with this directive, titled "Examination Procedures for Sports Franchise Acquisitions" for guidance on verifying acquired intangible assets, on closing agreements, on generally expected values of groups of sports franchise intangibles, and on making compliance measure calculations and adjustments.

4. *Expansion Teams.* The compliance measure will be made available to taxpayers who acquire an expansion team. However, agents should keep in mind the difference between an expansion and an existing team. An expansion franchise will provide the owner with rights to continually enter into and renew amortizable agreements. Thus, in looking at an expansion team, agents should expect to see a lower allocation to amortizable assets relative to such allocation for an existing team that has exercised its rights to enter into and renew amortizable agreements. Consequently, such a taxpayer may have a present value percentage from the amortization of intangible assets that is lower than the 60% maximum compliance measure mark.

5. *Claims.* Claims for amortization deductions will be considered under the terms and conditions of this directive in the same manner as amortization deductions claimed on original returns. Thus, if as of the date this directive is issued the taxpayer had not agreed to the acquisition issues (and the compliance measure is otherwise available), amortization deductions allowed under the measure may be attributable to additional amortization deductions claimed on an amended return.

### Compliance Measure Limitations

1. *Unavailability of Measure.* The compliance measure will not be made available in any case in which it is not in the interest of the Service or sound tax administration. Thus, for example, if an acquisition of a sports franchise presents rare and unusual allocation, valuation or amortization issues, the compliance measure will not be made available. A team's use of an in-house prepared valuation rather than one prepared by an outside appraisal firm does not, in and of itself, present a rare and unusual valuation issue. In any case in which the examination team feels that the compliance measure should not be made available, the team manager must discuss the matter with the Sports Industry Technical Advisor prior to informing the taxpayer of its initial conclusion. If the Sports Industry Technical Advisor concurs with the examination team, the team will inform the taxpayer of its conclusion. If the taxpayer disagrees with the examination team's decision, the taxpayer may appeal the decision to the team's Territory Manager, and, until resolved, to each of the progressing level of management up to the final level of Industry Director. The availability of the method will be in the sole discretion of the Industry Director. In any case in which the measure is not made available to a taxpayer, the examination of the acquisition issues will continue in the normal manner.

2. *Limited Determination.* The Service's use of the compliance measure is not in itself a final determination of the basis of any specific asset. Thus, for example, if a player contract becomes the subject of a like-kind exchange, the use of the compliance measure will not in anyway preclude the Service from examining the basis that passes from the exchanged contract to the received contract. Similarly, if the taxpayer's acquired intangible assets include an equity interest, the use of the compliance measure will not preclude in anyway the Service from examining the basis of that equity interest for any purpose, such as the determination of gain or loss on the subsequent transfer of the interest.

### Duration of Compliance Measure

The compliance measure takes into account CTM's examination experience, and its observations of the sports industry and its trends. Major future structural and economic changes in the industry may warrant a re-evaluation of the compliance measure. Thus, for example, the compliance measure may be materially affected by major changes in the value of future broadcast contracts that in turn materially affect the

purchase price allocation to amortizable intangible assets. Through the Technical Advisor Program, CTM will continue to monitor the sports industry for structural and economic changes.

Contacts

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cc: Commissioner and Deputy Commissioner, LMSB  
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